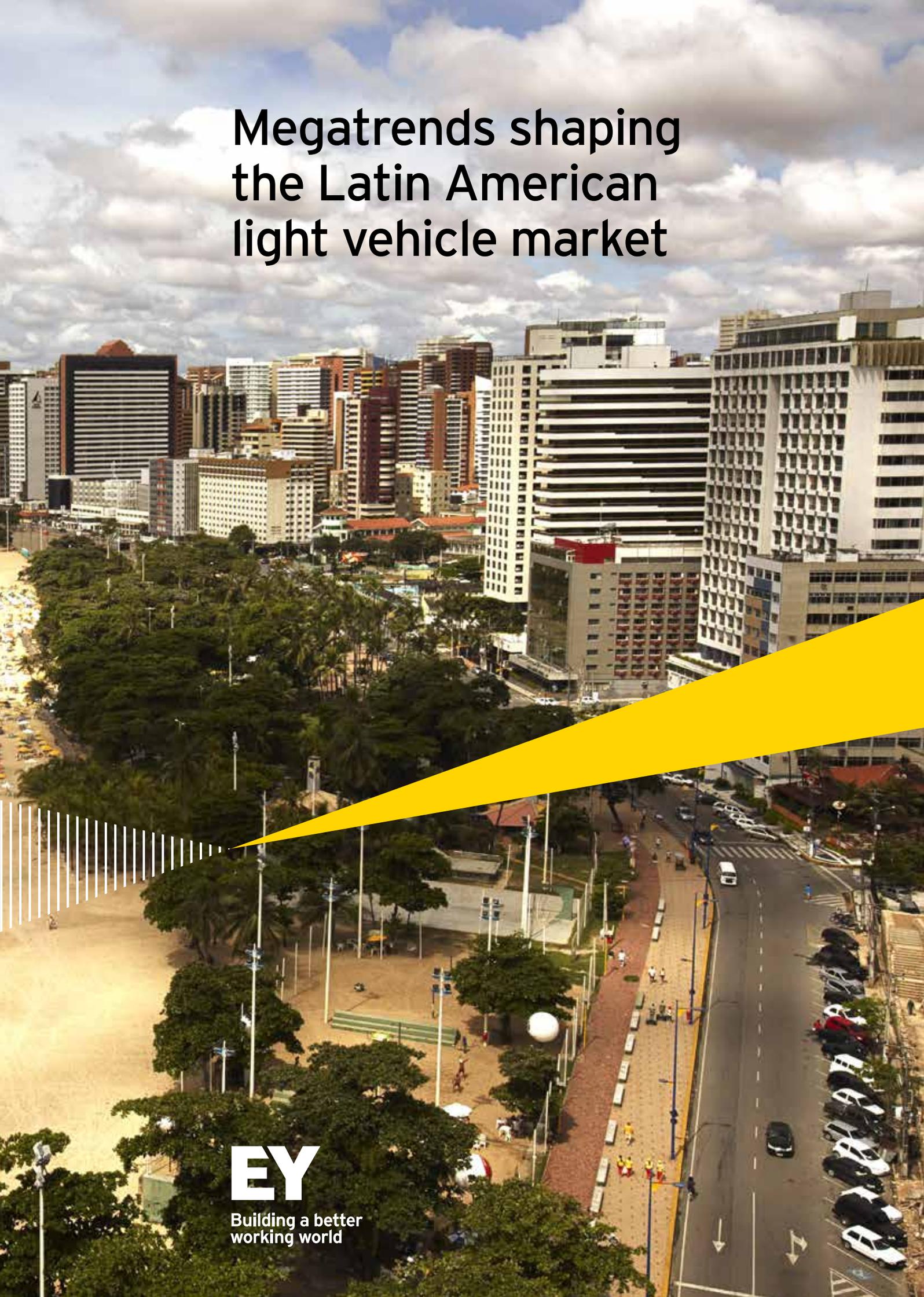


Megatrends shaping the Latin American light vehicle market

An aerial photograph of a city, likely Rio de Janeiro, showing a mix of modern high-rise buildings and older structures. A large green park area with many palm trees is visible in the middle ground. In the foreground, there's a wide road with cars and a pedestrian walkway. A yellow diagonal graphic element cuts across the lower right portion of the image. The sky is filled with white and grey clouds.

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What is shaping the Latin American light vehicle market?

The Latin America* region is continuing its evolution into an established manufacturing and sales hub for the automotive industry, made attractive by free trade agreements and increased government incentives. Further, it is also characterized by a growing population with increased purchasing power, continued investment into infrastructure and the governments' increasing focus on having in-house automotive production. The automotive industry in the region is expected to see a high growth over the medium term with the production of light vehicles (LVs) expected to grow at a CAGR of 6.88% over the next four years – from 7.3 million to 9.6 million units by 2017. Sales are also expected to show a growth rate of 5.89% over the same four years.

Consequently, stakeholders across the Latin American LV market are likely to be significantly impacted by rapidly changing events across the ecosystem – from the operating and regulatory environments, competition, and distribution channels to the supply chain.

To prepare for the years ahead, automakers, suppliers and dealerships across the Latin American LV market therefore need to ask themselves the following five questions and assess how well they are prepared to respond to evolving opportunities and challenges in the domain:

- ▶ How will the demand for vehicles evolve?
- ▶ How will products need to adapt?
- ▶ How will business models need to adapt?
- ▶ What are the supply or value chain issues and implications?
- ▶ What are the new market dynamics?

In attempting to answer these questions, EY has identified five megatrends that will impact the operations, revenues, costs and profitability of participants in the Latin American LV market.

Trendicators

Demographics

405.5 million

Combined population as of July 2013

New vehicles

6%

Expected LV sales CAGR 2013-17

70%

Value of the vehicle sold that is financed in Latin America

20

Years behind US and European regulations

Trade

50+

Number of existing free trade agreements between Latin America and other markets

64%

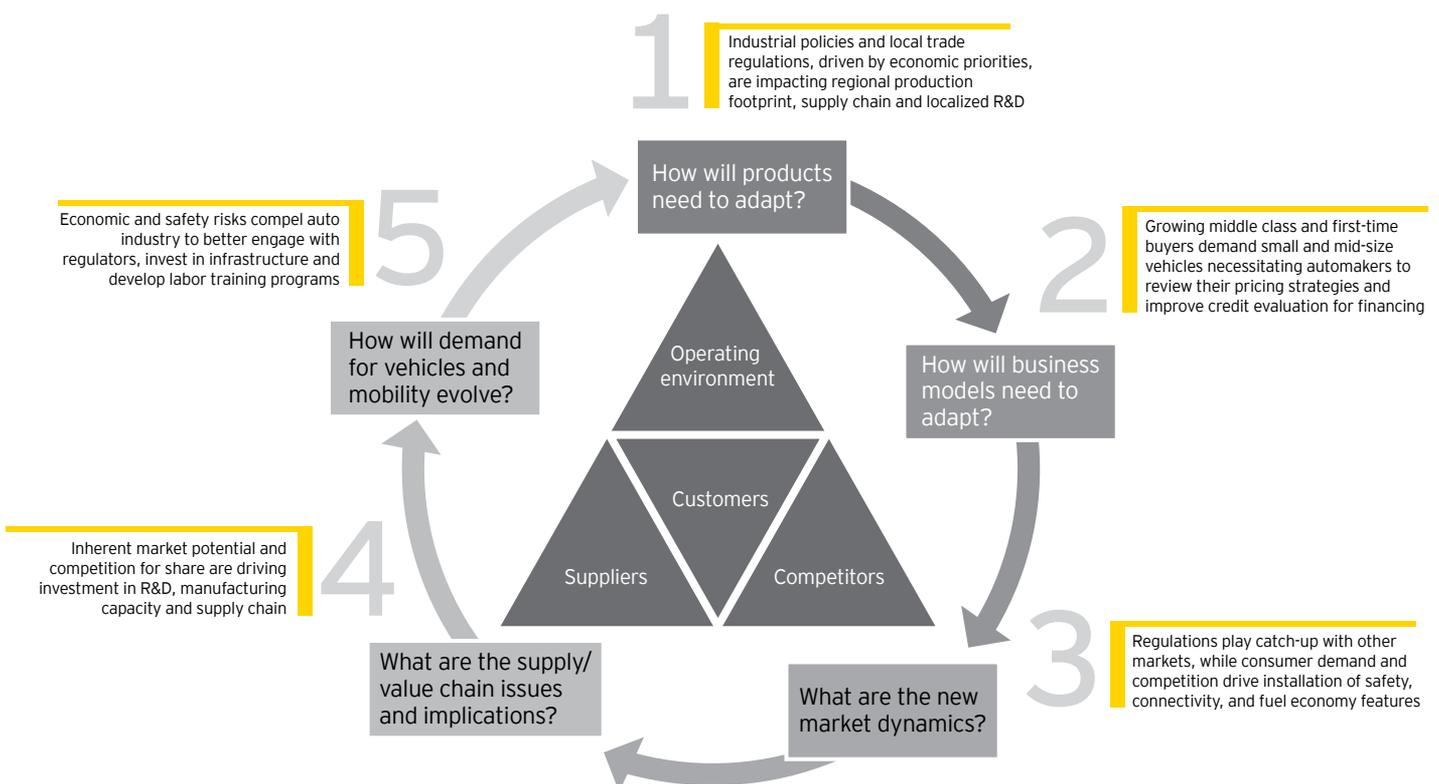
Share of exports from Mexico into the US

Investments

US\$17.7 billion+

Investments in regions (2007-16)

Sources: CIA World Factbook, LMC Automotive, EY Analysis, ANFAVEA, ProMèxico.



*Defined as Mexico, Brazil, Colombia and Argentina for the purpose of this piece.

1 Industrial policies and local trade regulations, driven by economic priorities, are impacting regional production footprint, supply chain and localized R&D.

- ▶ Import quotas and taxes are forcing OEMs and suppliers to adhere to government regulations and requirements.
- ▶ Incentives are driving industry players to invest in local R&D and engineering as well as creating and maintaining jobs for local workers.

2 Growing middle class and first-time buyers demand small and mid-size vehicles necessitating automakers to review their pricing strategies and improve credit evaluation for financing.

- ▶ Household income has been increasing due to better employment opportunities and improved economic conditions, leading to higher purchasing power.
- ▶ Consumers are financing a greater proportion of vehicle value, leading to an increase in auto loan default rates.

3 Regulations play catch-up with other markets, while consumer demand and competition drive installation of safety, connectivity and fuel economy features.

- ▶ Proposed fuel economy requirements as well as the introduction of minimum legal crash test standards are forcing OEMs and suppliers to focus on R&D and investments in technology and safety.
- ▶ Consumers are calling for comfort, convenience and safety features along with connectivity, telematics and vehicle tracking.

4 Inherent market potential and competition for share are driving investment in R&D, manufacturing capacity and supply chain.

- ▶ Established OEMs are strengthening operations to utilize regional cost competitiveness and responding to new regulations.
- ▶ Small-scale players in the region and new OEM entrants are setting up, localizing and expanding their production capacity in the region to take advantage of local growth and export potential.

5 Economic and safety risks compel auto industry to better engage with regulators, invest in infrastructure and develop labor training programs.

- ▶ Risks such as the lack of infrastructure in certain countries and the growing concern for environmental sustainability are driving players to work with local governments to take necessary measures in order to operate.
- ▶ The shortage of technically trained professionals, along with strong labor laws and union presence, is pushing OEMs and suppliers to ensure compliance with labor laws.

Key strategies for consideration of stakeholders	OEMs	Suppliers	Retail, distribution and finance	
	Evolution of demand for vehicles	<ul style="list-style-type: none"> ▶ Rationalize the footprint to maximize the growth potential of the regions ▶ Take advantage of new tax incentives on cars by manufacturing vehicles and parts locally and investing in R&D 	<ul style="list-style-type: none"> ▶ Cooperate with new entrants to support their regional expansion ▶ Review portfolio of products to ensure alignment with regional demand 	<ul style="list-style-type: none"> ▶ Addition of dealerships in strategic areas ▶ Enhanced service and parts operations to be more consumer-friendly and price-competitive
	Adapting products	<ul style="list-style-type: none"> ▶ Integrate local consumer preferences (e.g. technology, safety, fuel efficiency and styling) into vehicles ▶ Upgrade content in regional passenger vehicles model lineup 	<ul style="list-style-type: none"> ▶ Emission reduction/fuel efficiency and safety technologies potential in the Latin American markets ▶ Strategy to meet local-content production and manufacturing requirements 	<ul style="list-style-type: none"> ▶ Strategy in place to deal with loan defaults and turned-in vehicles ▶ Consider balancing services with selling vehicles ▶ Financing for those with lower or no credit
	Adapting business models	<ul style="list-style-type: none"> ▶ Plan for changing tax and incentives landscape ▶ Put in place human capital strategy to hire and train workers ▶ Prepare and risk-plan for annual negotiations with labor unions 	<ul style="list-style-type: none"> ▶ Utilize low-cost locations in Latin America to supply regional and foreign markets ▶ Preparations and risk planning for annual negotiations with labor unions 	<ul style="list-style-type: none"> ▶ Strategy in place to offer affordable financing for consumers while still making a profit ▶ Marketing strategy in place to reach existing drivers and those just entering the market ▶ Training programs for employees
	Addressing supply/value chain issues	<ul style="list-style-type: none"> ▶ Develop a strong and flexible import/export strategy ▶ Encourage suppliers to invest and locate near OEM facilities ▶ Evaluate tax and customs duty efficiency of regional supply chain footprint 	<ul style="list-style-type: none"> ▶ Enterprise management systems that enable visibility across the lower tiers of your supply chain ▶ Location of plants in relation to OEMs ▶ Develop logistics strategy to deliver components to OEMs and to comply with import/export regulations 	<ul style="list-style-type: none"> ▶ Advanced enterprise management system to manage inventory, working capital/cash, cost to serve and present total delivered costs
	Preparing for new market dynamics	<ul style="list-style-type: none"> ▶ Creation and development of infrastructure ▶ Plan for new safety and environmental regulations and crash tests and recyclability ▶ Supply chain restructuring that OEMs are likely to undertake to increase resilience in their network 	<ul style="list-style-type: none"> ▶ Position business to be flexible with market and client demands in order to maintain and grow contracts/relationships with existing OEMs and new entrants ▶ Focus on partnering and sales to new OEM entrants in these regions 	<ul style="list-style-type: none"> ▶ The free flow of goods, service and investment in the Latin American markets as envisioned by the creation of ECA-55 and INOVAR ▶ Work with OEMs to promote the sustainability of vehicles

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